MARYLAND LOTTERY AND GAMING CONTROL AGENCY
an agency of the State of Maryland

FINANCIAL STATEMENTS
For the Years Ended June 30, 2013 and 2012

MARYLAND LOTTERY AND GAMING CONTROL AGENCY

FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

TABLE OF CONTENTS

STOUT, CAUSEY & HORNING

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Maryland Lottery and Gaming Control Agency:

Report on the Financial Statements

We have audited the accompanying financial statements of the Maryland Lottery and Gaming Control Agency (an agency of the State of Maryland) (MLGCA), which comprise the statements of net position as of June 30, 2013 and 2012, the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the Maryland Lottery and Gaming Control Agency as of June 30, 2013 and 2012 and its changes in net position and its cash flow for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis of Accounting

As discussed in Note 1, the financial statements of the MLGCA are intended to present the financial position and the changes in financial position and cash flows, where applicable, of the MLGCA. They do not purport to, and do not, present fairly the financial position of the State of Maryland as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 19 and 45 through 46, respectively, be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Government Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards,* we have also issued our report dated September 30, 2013, on our consideration of the Maryland Lottery and Gaming Control Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Maryland Lottery and Gaming Control Agency's internal control over financial reporting and compliance.

Stout, Causey & Horning, P.A.

September 30, 2013

The following Management's Discussion and Analysis (MD&A) provides an overview of the Maryland Lottery and Gaming Control Agency's (MLGCA) performance for the fiscal years ended June 30, 2013 and 2012. As you read the MD&A, 2013 refers to the fiscal year ended June 30, 2013, 2012 refers to the fiscal year ended June 30, 2012 and 2011 refers to the fiscal year ended June 30, 2011. The information contained in the MD&A should be read in conjunction with the information contained in the financial statements and notes to the financial statements, which begins on page 20.

FINANCIAL HIGHLIGHTS

- Net lottery sales were $1.756 billion in 2013, a decrease of $38.8 million or -2.16% as compared to 2012, which increased $80.5 million or 4.70% as compared to 2011.

- Cost of sales increased by $135.4 million or 10.62% in 2013 as compared to 2012 which increased $109.5 million or 9.04% as compared to 2011. The major reason for the increase was an increase in commissions paid to casino operators. In 2013, there were three casinos with a full year of operations and a fourth casino which opened in May 2013 compared to two casinos with a full year of operation in 2012 and a third casino opening in June 2012. In addition, table games were launched in the second half of 2013. Casino operators receive a share of revenue generated from both the VLTs (Video Lottery Terminals) and the table games. The overall increase was slightly offset by a decrease in lottery prizes due to players. The majority of the increase in 2012 from 2011 was the result of an increase in commissions paid to casino operators and an increase in lottery prizes due to players.

- Operating expenses increased by $58.3 million or 103.43% in 2013 compared to 2012 which decreased $32.5 million or 36.55% as compared to 2011. The increase in operating expenses in both 2013 and 2012 is attributed to the costs incurred to regulate the casinos.

- Transfers to the State of Maryland and the Stadium Authority from lottery proceeds in 2013 were $545.2 million, a decrease of $11 million or -1.98% as compared to 2012, which increased $36.9 million or 7.10% as compared to 2011.

- Gross video lottery terminal revenue was $560.7 million in 2013, an increase of $365.6 million or 187.39% as compared to 2012, which increased $92 million or 89.17% as compared to 2011.

- Table games debuted in the second half of 2013. Table game revenue generated in 2013 totaled $48 million.

- Transfers to various State agencies from video lottery terminal and table game revenue in 2013 totaled $376.5 million, an increase of $247.6 million or 192.16% as compared to 2012, which increased $61.66 million or 91.72% as compared to 2011.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Maryland Lottery and Gaming Control Agency is an independent agency of the State that was created to generate revenue through the operation of a lottery. On November 4, 2008, a constitutional amendment was approved by voters which set up broad parameters for the operations of VLTs and the establishment of five VLT Facility locations (referred to as casinos) in the State. During the 2012 Second Special Session of the Maryland General Assembly, legislation passed, subject to voter referendum, that allowed, among other things, the implementation of table games as well as a sixth casino. During the November 2012 election, voters approved both table games and the sixth casino. The MLGCA is responsible for regulating the operations of the casinos. As of June 30, 2013, there were four casinos operational in the state with 6,830 VLTs and 154 table games.

The MLGCA is accounted for as a proprietary-type enterprise fund using the accrual basis of accounting, similar to a private business entity.

Financial Statements

The financial statements included in this report are: the statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. The statements of net position present the assets and liabilities of the MLGCA with the difference between the two being reported as net position. The statements of revenues, expenses, and changes in net position report the revenues and expenses of the MLGCA and are used to measure the success of its operations for a given period of time as it relates to contributions to the State of Maryland and other government agencies. The statements of cash flows reconcile the changes in cash and cash equivalents with the activities of the MLGCA for the periods presented. The activities are classified as operating, noncapital financing, capital and related financing, and investing.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 24 to 43 of this report.

FINANCIAL ANALYSIS

Table 1 is a summarized version of the statements of net position as of June 30, 2013, 2012 and 2011. The table reflects the MLGCA's overall change in financial resources and claims on those resources. The majority of the assets consist of cash held by the State Treasury, investments, accounts receivable and cash and cash equivalents – gaming. The MLGCA's investments and the majority of accounts receivable, as well as the majority of cash held by the State Treasury, are used to pay lottery winners or are transferred as income to the State of Maryland. The remaining portion of cash held by the State Treasury is gaming revenue that is to be transferred to other State agencies. The majority of the cash and cash equivalents – gaming are the operator license fees that were received from applicants applying for casino licenses. Significant liabilities represent prize awards payables, annuities payable, amounts due to the State of Maryland, amounts due to other government agencies, escrow payables related to gaming and capital lease obligations.

Table 1
Net Position
(in thousands)

	2013	2012	2011
Current Assets	$ 222,418	$ 176,533	$ 173,220
Non-Current Assets	45,933	59,192	70,077
Capital Assets, net	23,826	49,230	38,433
Total Assets	$ 292,177	$ 284,955	$ 281,730
Current Liabilities	$ 231,987	$ 194,516	$ 181,655
Non-Current Liabilities	55,212	78,282	94,128
Total Liabilities	$ 287,199	$ 272,798	$ 275,783
Net Position			
Net Investment in capital assets	$ (7,197)	$ (6,983)	$ (6,882)
Unrestricted	12,175	19,140	12,829
Total Net Position	$ 4,978	$ 12,157	$ 5,947

<u>**Current Assets**</u>

The MLGCA's current assets increased by $45.9 million or 25.99% in 2013 compared to 2012 which increased by $3.3 million or 1.91% compared to 2011. The corresponding increases and decreases are as follows:

Cash and Cash Equivalents – Gaming (which includes gaming escrow and gaming licensing deposits) increased $48.7 million or 171.62% in 2013 compared to 2012 which increased by $25.05 million or 756.33% to 2011. Cash and cash equivalents – gaming are primarily the funds received from applicants who applied for a casino operator license and to a lesser extent, funds received from entities and individuals seeking to receive a gaming license. The increase in 2013 is primarily related to license fees received for the sixth casino which was authorized during the 2012 Special Session of the Maryland General Assembly. In February 2013, a request for proposals was released for a sixth casino site located in Prince George's

Current Assets – (continued)

County. The law requires bidders to submit an initial license fee of $3 million for every 500 VLTs proposed. Licenses fees totaling $53.1 million were received from three interested bidders.

The increase in license fees was slightly offset by the transfer of $2.1 million to the Education Trust Fund after the award for the casino license to Rocky Gap Casino Resort and the $2.8 million transferred to the court systems for an unsuccessful Baltimore City bid. The increase in 2012 from 2011 is attributed to license fees received for the Baltimore City and Rocky Gap casino locations. In 2012, the MLGCA received $22.5 million in license fees from the Baltimore City casino applicant and $2.1 million in license fees from the Rocky Gap casino applicant.

Accounts receivable increased by $3.3 million or 7.9% in 2013 compared to 2012 which increased $10.4 million or 33.49% compared to 2011. Accounts receivable is primarily comprised of amounts due from lottery retailers from the sale of lottery tickets and gross terminal revenue due from the casino operators. Accounts receivable from lottery retailers increased $780,000 or 2.16% in 2013 compared to 2012 which increased $5.6 million or 18.24% as compared to 2011. On a weekly basis, amounts due from retailers are collected electronically from the retailers' bank accounts. On June 30, 2013, seven days of sales activity were waiting to be collected compared to six days at June 30, 2012 and four days at June 30, 2011.

Accounts receivable from casino operators increased by $2.5 million or 46.28% in 2013 compared to 2012 which increased $4.8 million or 851.11% compared to 2011. On a daily basis, the gross terminal revenue generated by the casinos is wired to the MLGCA. The increase in 2013 was due to four casinos generating revenue on June 30, 2013 compared to three casinos generating revenue on June 30, 2012. Furthermore, seven days of table game revenue was waiting to be transferred at the end of June 2013. The increase in 2012 from 2011 was the result of three casinos generating gross terminal revenue on June 30, 2012 compared to only two casinos on June 30, 2011. In addition, the two casinos in 2011 were much smaller in size.

The increase in current assets was offset by a decrease in cash held with the State Treasury and a decrease in the current portion of investments for annuity payments.

Cash held with the State Treasury decreased by $1.7 million or 1.93% in 2013 compared to 2012 which decreased by $28.9 million or 25.0% compared to 2011. Cash held with the State Treasury primarily represents cash received from lottery agents from the sale of lottery tickets, cash received from casinos for the revenue generated by gaming operations, income waiting to be transferred to the State from the lottery and gaming proceeds, unpaid prizes and unclaimed prizes. Changes in these balances have a corresponding effect on the MLGCA's cash position. The decrease from 2013 to 2012 is the result of both lottery revenue being less in June 2013 than in June 2012. In addition, a law change that took effect on October 2012 allowed casino operators to retain their commissions for operating the casinos. Prior to this change, MLGCA would collect the commissions and transfer them back to the casino operators at the end of each month. The decrease between 2012 and 2011 was due to there being only one month worth of lottery revenue waiting to be transferred at the end of 2012 in comparison to two months at the end of 2011. The decrease was slightly offset by an increased amount of VLT revenue waiting to be transferred. June's 2012 VLT revenue was higher than June 2011 due to the opening of the third casino.

Current Assets – (continued)

The current portion of investments for annuity payments decreased by $3.6 million or 21.47% from 2012 which decreased by $4.3 million or 20.20% compared to 2011. The continued decreases during these years resulted from fewer jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that expired.

Non-Current Assets

The Lottery's non-current assets consists of investments for annuity payments, net of current portion and capital assets, net of depreciation and amortization. Non-current assets decreased by $38.7 million or 35.66% in 2013 compared to 2012 which decreased slightly by $88,000 or .08% compared to 2011.

Capital assets, net of depreciation and amortization, decreased by $25.4 million or 51.60% in 2013 compared to 2012 which increased by $10.8 million or 28.09% compared to 2011. The decrease in 2013 is attributed to a full year's worth of depreciation and amortization for certain VLTs that are treated as capital leases. Under the law, the lottery is required to own or lease the VLTs that are in the casinos. Owned VLTs are capitalized at cost and depreciated over a five-year period. Certain VLTs are leased and are treated as capital leases. These VLTs have a guaranteed lease period ranging from 12 to 18 months and are capitalized at the lower of their fair value or present value of minimum lease payments and are amortized over their guaranteed lease period. The increase in 2012 is attributed primarily to capitalizing the VLTs that met the criteria for capital leases. This increase was offset by a full year's worth of depreciation and amortization for the VLTs that were purchased for the two casinos that opened in 2011 as well as one month's amortization for certain VLTs that were leased beginning in June 2012. Details of capital assets, additions and depreciation are included in Note 4 to the financial statements, on page 36.

The Lottery's investments for annuity payments, net of current portion, decreased by $13.3 million or 22.40% in 2013 as compared to 2012 which decreased by $10.9 million or 15.53% as compared to 2011. These continued decreases resulted from fewer jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that have expired.

Current Liabilities

Current liabilities increased by $37.5 million or 19.26% in 2013 compared to 2012 which increased by $12.8 million or 7.08% compared to 2011. The majority of the increase from 2012 to 2013 is attributed to Gaming Escrow Payable and Transfers due Other Government Agencies – VLT.

Gaming Escrow Payable increased by $48 million or 173.65% in 2013 compared to 2012 which increased by $24.6 million or 811.71% compared to 2011. The increase in 2013 was the result of the receipt of casino application fees totaling $53.1 million from three bidders for the sixth casino location in Prince George's County. The increase was slightly offset by a transfer of $2.1 million to the Education Trust Fund after the award for the Rocky Gap Casino Resort was made and the return of $3 million to an unsuccessful bidder for the Baltimore City casino location. The increase in 2012 from 2011 is attributed to application fees received for the Baltimore City and Rocky Gap casino locations.

Transfers due to other government agencies increased by $9.8 million or 34.83% in 2013 compared to 2012 which increased $20.0 million or 244.28% compared to 2011. This amount represents the June VLT revenue waiting to be transferred to other government agencies. The increase in 2013 is attributed to a full month of operation for Maryland Live! Casino (versus a partial month in 2012), the additional

Current Liabilities – (continued)

casino, Rocky Gap Casino Resort, and the implementation of table games. The increase in 2012 compared to 2011 was attributed to three casinos opened in 2012 compared to two casinos in 2011.

The increases in current liabilities in 2013 were offset primarily by decreases in Transfer due to the State of Maryland General Fund, the current portion of annuity prizes payable and the current portion of capital lease obligations.

Transfer due to the State of Maryland General Fund decreased by $6.8 million in 2013 or 15.68% compared to 2012 which decreased by $38.2 million or 46.94% compared to 2011. The decrease from 2013 to 2012 is attributed to lower revenue in June 2013 than in June 2012. The decrease from 2012 to 2011 is attributed to one months of lottery revenue waiting to be transferred at the end of 2012 in comparison to two months at the end of 2011.

The current portion of annuity prizes payable decreased by $3.2 million or 18.87% in 2013 compared to 2012 which decreased $4.3 million or 20.19% from 2011. The continued decreases in the current portion of annuity prizes payable resulted from fewer jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that have expired.

Current portion of capital lease obligations decreased by $11.8 million or 45.54% in 2013 compared to 2012 which increased by $16 million or 161.59% in 2012 compared to 2011. The decrease in 2013 is attributed to the full year of lease payments of certain VLTs that met the criteria for capital leases. The increase in 2012 was attributed to the lease of certain VLTs that were leased for the casino that opened in June 2012. These machines have a guaranteed lease period ranging from 12 to 18 months and meet the criteria for a capital lease. Machine manufactures are paid on a monthly basis.

Non-Current Liabilities

Non-current liabilities decreased by $23.1 million or 29.47% in 2013 compared to 2012 which decreased by $15.8 million or 16.83% compared to 2011. The decreases are primarily attributed to decreases in annuity prizes payable and capital lease obligations, net of current portion.

Annuity prizes payable decreased by $9.5 million or 20.23% in 2013 compared to 2012 which decreased by $11.7 million or 19.99% as compared to 2011. The primary reason for these decreases is fewer jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that expired. A similar decrease in non-current investments for annuity payments is discussed above. Additional information on the MLGCA's non-current liabilities may be found in Notes 5, 6, and 7 to the financial statements, beginning on page 37.

Capital lease obligations, net of current portion decreased by $13.4 million or 44.19% in 2013 compared to 2012 which decreased $4.7 million or 13.37% compared to 2011. The decreases in both years are attributed primarily to the capital leases recognized for the VLTs leased at the casino that opened in June 2012. These VLTs have a specified lease period of 12 to 18 months making the majority of the payment due, current as opposed to non-current.

Net Position

Net position decreased by $7.2 million or 59.05% in 2013 compared to 2012 which increased by $6.2 million or 104.41% compared to 2011. Because the MLGCA is required by law to transfer its entire budgetary basis net income to the State of Maryland and its gaming revenue to state government agencies, changes in net position do not reflect the results of the MLGCA's operating activities. Rather, changes in net position reflect differences between budgetary basis net income and net income in accordance with accounting principles generally accepted in the United States of America and the unclaimed prize fund.

The decrease in net position from 2013 to 2012 is attributed to the decrease in unrestricted assets which consists of unrealized gains or losses on investments, outstanding encumbrances and the unclaimed prize fund. The majority of this decrease is attributed to the loss on investments. The increase in net position in 2012 from 2011 is attributed primarily to the gain on investments.

Results of Operations

Table 2 is a summarized version of the statements of revenues, expenses, and changes in net position for the years ended June 30, 2013, 2012 and 2011.

Table 2
Revenues, Expenses, and Changes in Net Position
(in thousands)

	2013	2012	2011
Sales			
Draw games	$1,270,280	$1,288,089	$1,220,854
Instant games	485,839	506,804	493,548
Total sales	1,756,119	1,794,893	1,714,402
Gaming Revenue – Gross Terminal Revenue	560,679	195,093	103,133
Gaming Revenue – Table Games	48,038	-	-
Gaming Revenue – State Grant	73,691	28,959	9,605
Gaming Revenue – Facility Applicants	2,704	1,791	1,342
Gaming Revenue – Terminal Assessment	2,964	1,709	
Total Revenue	**2,444,195**	**2,022,445**	**1,828,482**
Cost of sales	1,409,998	1,274,624	1,202,399
Gross profit	**1,034,197**	**747,821**	**663,348**
Operating expenses	114,663	56,365	51,576
Income from operations	**919,534**	**691,456**	**574,507**
Non-operating expenses			
Unrealized gain (loss) on investments	(4,232)	811	(3,785)
Interest expense	(720)	(911)	(120)
Interest income	-	-	7
Payments to State of Maryland General Fund and Stadium Authority	(545,225)	(556,265)	(519,394)
Payments to Other Government Funds- Gaming	(376,536)	(128,881)	(67,225)
Total non-operating expenses	**(926,713)**	**(685,246)**	**(590,517)**
Change in Net Position	**(7,179)**	**6,210**	**(16,010)**
Total Net Position – beginning of year	12,157	5,947	21,957
Total Net Position – end of year	**$4,978**	**$12,157**	**$5,947**

Sales

Net sales were $1.756 billion, a decrease of $38.8 million or 2.16% as compared to 2012, which increased $80.5 million or 4.69% as compared to 2011.

Lottery sales are categorized as draw or instant games. Draw games are further categorized as Numbers, Monitor and Matrix games.

Draw games sales decreased $17.8 million or 1.38% in 2013 as compared to 2012, which increased by $67.23 million or 5.51% as compared to 2011. In 2013, sales decreases occurred in both Number games and Monitor games while Matrix games increased. In 2012, growth occurred in all draw game categories with the most significant growth occurring in the Matrix game category. In 2011, the growth in draw games sales was attributable to the Monitor and Numbers games which was offset by a slight decline in Matrix games as shown in Table 3.

Table 3
Net Sales of Draw Games
(in thousands)

	2013	2012	2011
Numbers	$513,323	$520,135	$515,463
Monitor	493,570	521,674	496,731
Matrix	263,387	246,280	208,660
Total	$1,270,280	$1,288,089	$1,220,854

Sales for the Numbers games, which are Pick 3 and Pick 4, decreased by $6.8 million or 1.31% in 2013 as compared to 2012, which increased by $4.7 million or .91% as compared to 2011. Pick 4 sales increased in both 2013 and 2012 by $2.3 million or .85% and $10.9 million or 4.28%, respectively whereas Pick 3 sales decreased in both 2013 and 2012 by $9.0 million or 3.56% and $6.2 million or 2.39%, respectively. The increase in Pick 4 sales and the continued decrease in Pick 3 sales can be attributed to the top prize offered in these games. The top prize for Pick 3 is $500, whereas the top prize for Pick 4 is $5,000. It is further believed that the continued decrease in Pick 3 may be the result of the continued growth in Racetrax® sales. Racetrax® offers a trifecta bet that plays like Pick 3 but has better odds of winning.

Sales for the Monitor games, which include Keno, Keno Bonus, Keno Super Bonus, Racetrax®, and Racetrax® Bonus decreased by $28.1 million or 5.39% in 2013 as compared to 2012 which increased by $24.9 million in 2012 or 5.02% as compared to 2011. Keno games decreased by $42.6 million or 11% in 2013 as compared to 2012, which increased by $6.8 million or 1.80% as compared to 2011. It is believed that the decrease in the Keno games may be attributed to the opening of the Maryland Live! Casino in June 2012.

The decrease in the Keno games was offset by the continued increase in the Racetrax® games. Racetrax® games increased by $14.5 million or 10.8% in 2013 as compared to 2012, which increased by $18.1 million or 15.58% as compared to 2011. This game continues to grow as it is fast action and offers a trifecta which is attractive to numbers players.

Sales – (continued)

Sales for Matrix games, which includes Powerball and Powerplay, Mega Millions and Megaplier, Bonus Match 5, Multi-Match, and 5 Card Cash increased by $17.1 million or 6.95% in 2013 compared to 2012, which increased by $37.6 million or 18.03% as compared to 2011.

Of all the Matrix games, Powerball, combined with Powerplay, was the only game that showed growth over 2012. Powerball and Powerplay sales increased by $48.5 million or 58.52% in 2013 compared to 2012, which increased $25.1 million or 43.58% compared to 2011. The growth in 2013 can be attributed to the jackpot rolling in excess of $100 million six times. Two of these times, the jackpot reached $550 million and $600 million, respectively. The majority of the growth in 2012 over 2011 can be attributed to the game changes. In January 2012, the cost of the Powerball game went from $1 to $2. As a result of the price increase, the starting jackpot went from $20 million to $40 million, the odds of winning the jackpot changed to 1:175 million from 1:195 million and the prize for matching the five white balls increased from $200,000 to $1 million.

Sales of Mega Millions, combined with Megaplier, decreased by $39.8 million or 35.93% in 2013 compared to 2012, which increased by $9.2 million or 9.09% in 2012. The decrease in 2013 is attributed to the lack of high jackpots in comparison to Powerball. During 2013, the Mega Millions jackpot only rolled in excess of $100 million two times with the highest jackpot reaching only $190 million. The increase in 2012 over 2011 is attributed to the jackpot rolling a total of 18 times between January 27, 2012 and March 30, 2012 to set a world record jackpot of $656 million.

Bonus Match 5 sales decreased by $788,000 or 3.61% in 2013 compared to 2012, which increased by $478,000 or 2.23% compared to 2011. Multi-Match sales decreased by $2 million or 6.36% in 2013 compared to 2012, which increased by $2.8 million or 9.88% compared to 2011. The increases/decreases in Multi-Match between the years are attributed to jackpot amounts. Multi-Match jackpots in 2013 were lower than in 2012, which were higher than in 2011.

In November 2012, a new game, 5 Card Cash was launched. 5 Card Cash is two draw games in one. It is based on a standard poker game using a 52 card playing deck and has both an instant win feature as well as a nightly drawing. For $2, the player receives five randomly selected cards. If the cards show a poker hand of Jacks or better, the player wins instantly. In addition, there is a nightly drawing where five cards are drawn and players win by matching 2, 3, 4 or 5 of the cards in the same suit and rank. Sales for this game in 2013 totaled $11.2 million.

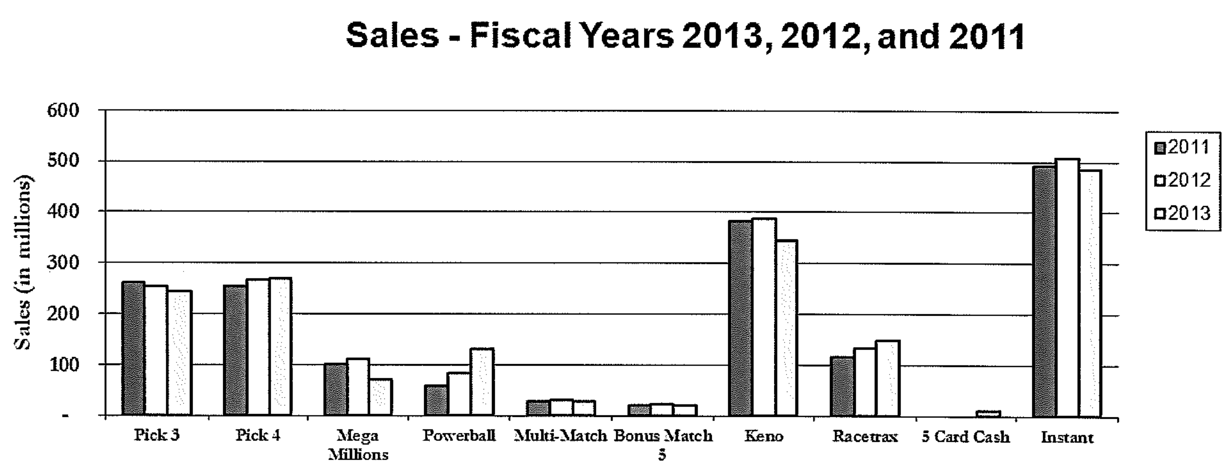
Instant games are the second category of lottery game offered to the public. Instant game sales increased by $19 million or 3.75% in 2013 as compared to 2012, which increased by $13.3 million or 2.69% as compared to 2011 as shown in Table 4. It is believed that the decrease in instant game sales can be attributed to the Federal sequestration and the opening of the casinos. Since Maryland has such a large number of government workers it is believed that the Federal sequestration significantly affected the discretionary income of instant ticket players. It is also believed that the opening of all of the casinos has affected instant ticket sales as the casinos offer instant gratification and provide a greater entertainment value. The increase in instant ticket sales in 2012 can be attributed to a change in the MLGCA's strategy for instant ticket launches. During 2012, the MLGCA increased the print run of the instant tickets and concentrated on producing more $5 price point tickets. The majority of the growth in 2012 occurred in the $5 price point tickets.

Sales – (continued)

Table 4
Net Sales of Instant Games
by Price Point
(in thousands)

	2013	2012	2011
$1	$28,406	$31,879	$38,541
$2	47,443	46,444	51,880
$3	40,532	44,889	44,970
$5	191,377	209,574	191,775
$10	155,902	109,107	100,725
$20	62,178	64,911	65,657
Total	$525,838	$506,804	$493,548

The following graph depicts the MLGCA's on-line and instant sales for 2013, 2012, and 2011. Keno, Keno Bonus and Keno Super Bonus sales (labeled as Keno for the chart below) have been combined as has Racetrax® and Racetrax ® Bonus sales (labeled as Racetrax for the chart below) Mega Million and Mega Plier (labeled as Mega Millions for the chart below) and Powerball and Powerplay (labeled as Powerball for the chart below).



Gaming Revenue – Gross Video Lottery Terminal Revenue, Table Game Revenue, State Grant, Facility Applicants Fees and Gaming Assessment

Gaming Revenue – Gross Terminal Revenue (GTR) represents the revenue generated by the VLTs net of total payouts. Gross Terminal Revenue in 2013 totaled $560.7 million, an increase of $365.6 million or 187.3% over 2012, which increased $92.0 million or 89.17% over 2011. The increase in 2013 is attributed to a full year of operation for the Maryland Live! Casino and, to a lesser extent, the opening of the Rocky Gap Casino Resort on May 22, 2013. The overall increase in 2013 was slightly offset by a decrease in revenue at the Hollywood Casino – Perryville. The decrease in 2013 at the Hollywood Casino – Perryville can also be attributed to the opening of the Maryland Live! Casino which offers more VLTs and is located in the Baltimore Metropolitan area. The increase from 2011 to 2012 is attributed to a full year of operation for both the Hollywood Casino – Perryville and the Casino at Ocean Downs and the opening of the Maryland Live! Casino in June 2012. The following table shows VLT statistics for the casinos.

Table 5
Gross Terminal Revenue Statistics

Casinos	Date Opened	Number of Machines as of June 30, 2013	2013 GTR (in millions)	2012 GTR (in millions)	2011 GTR (in millions)
Hollywood Casino Perryville	**September 27, 2010**	**1,158**	**$ 76.0**	**$118.1**	**$82.7**
Casino at Ocean Downs	**January 4, 2011**	**800**	**50.5**	**48.0**	**20.4**
Maryland Live! Casino	**June 6, 2012**	**4,314**	**431.4**	**29.0**	–
Rocky Gap Casino Resort	**May 22, 2013**	**558**	**2.8**	–	–
Total		**6,830**	**$560.7**	**$195.1**	**$103.1**

Gaming Revenue – Gross Video Lottery Terminal Revenue, Table Game Revenue, State Grant, Facility Applicants Fees and Gaming Assessment – (continued)

Gaming Table Game Revenue - During the 2012 Second Special Session of the Maryland General Assembly, legislation was passed, subject to voter referendum, that authorized table games at the casinos. During the November 2012 election, voters ratified the legislation and table games debuted in March 2013. Table game revenue generated in 2013 totaled $48 million. The following table shows table game statistics for the casinos.

Table 6
Table Game Revenue Statistics

Casino	Date Tables Debuted	Number of Tables as of June 30, 2013	Table Game Revenue 2013 (in millions)
Hollywood Casino – Perryville	March 6, 2013	22	$ 6.0
Maryland Live! Casino	April 11, 2013	122	41.6
Rocky Gap Resort Casino	May 22, 2013	10	.4
Casino at Ocean Downs	-	-	-
Total		154	$48.0

Gaming Revenue – Gross Video Lottery Terminal Revenue, Table Game Revenue, State Grant, Facility Applicants Fees and Gaming Assessment – (continued)

For the gaming operations, the gross terminal revenue is required to be transferred to specified Government agencies to be used for certain purposes or is retained by the casinos and the MLGCA to assist in covering the costs of the operations. The MLGCA retains 2% of the gross terminal revenue to help fund the gaming operations. All casinos, with the exception of the Rocky Gap Casino Resort retain 33% of the gross terminal revenue. Rocky Gap Casino Resort retains 50% of the gross terminal revenue. For table game revenue, 20% of the revenue is required to be transferred to the Education Trust Fund and the remaining 80% is retained by the casino operators. The table below shows the overall disbursements and allocations.

Table 7
2013 and 2012 Gaming Revenue Disbursements/Allocations

Fund	2013 Disbursements (in millions)	2012 Disbursements (in millions)	2011 Disbursements (in millions)
Maryland Education Trust Fund	**$284.5**	**$94.6**	**$49.9**
Casino Operators	**223.9**	**64.4**	**34.0**
Horse Purse Dedication	**39.1**	**13.7**	**7.2**
Local Impact Grants	**30.8**	**10.7**	**5.7**
Race Tracks Facility Renewal Accounts	**10.8**	**4.9**	**2.6**
Maryland Lottery and Gaming Control Agency	**11.2**	**3.9**	**2.1**
Small, Minority and Women-Owned Business	**8.4**	**2.9**	**1.6**
Total	**$608.7**	**$195.1**	**$103.1**

Gaming Revenue – State Grant represents funds received from the State of Maryland to help pay for the costs of the gaming operations. Gaming Revenue State Grant increased by $44.7 million or 154.46% in 2013 compared to 2012, which increased $19.35 million or 201.50% compared to 2011. The increase in both 2013 and 2012 is due to the increased funding needed to pay for the maintenance, purchase and leasing of the VLTs. In 2013, a full year's worth of funding was needed to pay for the machines at Maryland Live! in comparison to one month's worth of funding in 2012. The increase in 2012 from 2011 was the result of a full year's worth of funding for both Hollywood Casino – Perryville and The Casino at Ocean Downs, whereas in 2011 only a partial year's worth of funding was needed for both casinos.

Facility Applicant Fees - represents money received to perform background investigations on applicants who have applied for a gaming license. Facility Applicant Fees increased by $912,000 or 50.95% in 2013 compared to 2012 which increased by $450,000 or 33.5% in 2012 compared to 2011. The increase in 2013 is attributed to the debut of table games at three of the casinos which required the hiring of additional casino staff, the opening of the Rocky Gap Casino Resort in May 2013 and the turnover experienced at all of the casinos. The increase in 2012 from 2011 was attributed to the opening of Maryland Live! Casino.

<u>Gaming Revenue – Gross Video Lottery Terminal Revenue, Table Game Revenue, State Grant, Facility Applicants Fees and Gaming Assessment</u> – (continued)

Gaming Assessments – represents assessments made to casino operators based on the maximum number of VLTs on the floor during the fiscal year and the number of table games on the floor as of the end of the fiscal year. In accordance with the law, casino operators are assessed a yearly fee of $425 per VLT and $500 per table. These funds are collected by the MLGCA and subsequently remitted to the Department of Health and Mental Hygiene's Problem Gambling Fund. Gaming Assessments increased by $1.3 million or 73.46% in 2013 compared to 2012. The increase in 2013 is due to more VLTs in service in 2013 and the implementation of table games.

<u>Cost of Sales</u>

Cost of sales consists of lottery prize expense, lottery retailer commissions, casino operator commissions, costs paid to vendors to operate and maintain the lottery system and the gaming system, and costs paid for the printing and delivery of instant games. In 2013, the MLGCA reclassified commissions paid to casino operators from operational expenses to cost of sales. As such, costs of sales have been restated for 2012 and 2011 to reflect this change.

Cost of sales increased by $135.4 million or 10.62% in 2013 compared to 2012 which increased $72.2 million or 6.01% compared to 2011. The increase in 2013 is primarily attributed to the increase in casino operator commissions. Commission paid to casino operators increased by $159.5 million or 247.82% in 2013 compared to 2012 which increased by $30.3 million or 89.17% compared to 2011. The increase in 2013 in casino operator commissions is primarily attributed to a full year of operation of the Maryland Live! Casino versus less than a full month of operation in 2012. To a lesser extent, the 2013 increase is the result of the opening of the Rocky Gap Casino Resort in May 2013 and the implementation of table games. The increase in 2012 from 2011 is the result of a full year of operation for both Hollywood Casino – Perryville and the Casino at Ocean Downs as well as a partial month of operation for the Maryland Live! Casino.

Commissions paid to lottery retailers increased by $1.5 million or 1.25% in 2013 compared to 2012 which increased $4.6 million or 4.06% compared to 2011. Typically, increases and decreases in commission are a function of sales as retailers receive a percentage of all tickets sold and cashed at their location. Although sales decreased in 2013, commission paid to retailers increased as a result of a change in the commission fees earned. In January 2013, sales commission earned by retailers increased from 5% to 5 ½%. The increase in 2012 from 2011 is attributed to the overall increase in sales from 2011 to 2012.

The increase is cost of sales is partially offset by a decrease in prize expense in 2013. Prize expense decreased by $27.2 million or 2.55% in 2013 compared to 2012 which increased by $36.6 million or 3.56% from 2011. There is a direct correlation between prize expense and sales. As such, the decrease in 2013 is the direct result of the decrease in sales whereas; the increase in 2012 is the direct result of an increase in sales.

Operating Expenses

Operating expenses increased by $58.3 million or 103.43% in 2013 compared to 2012 which decreased $4.8 million or 9.29% compared to 2011. In 2013, the MLGCA reclassified casino operator commissions from operating expenses to costs of sales. As such the statements have been restated to reflect this change.

Fluctuations in operating expenses are primarily due to changes in the MLGCA's budgetary appropriation or the timing of liquidating prior year encumbrances. While lottery operating expenses and encumbrances have remained relatively stable for the past several years, the operating expenses of the gaming program increased significantly in 2013, 2012 and 2011. Administrative Expenses – Gaming increased by $63.8 million or 268.29% in 2013 compared to 2012 which increased by $14.1 million or 146.30% compared to 2011. The increase in 2013 is attributed primarily to a full year of lease payments on the VLTs at the Maryland Live! Casino versus a partial month payment in 2012. The increase in 2012 from 2011 is the result of a full year of payments made for the maintenance, lease and purchase of the VLTs at the Hollywood Casino – Perryville and the Casino at Ocean Downs versus a partial year of payments in 2011.

Depreciation and amortization also contributed to the increase in the total operating expenses. Depreciation and amortization increased by $14.6 million or 134.85% in 2013 compared to 2012 which increased $3.6 million or 49.06% compared to 2011. The increase in 2013 is primarily attributed to a full year's worth of amortization for certain leased VLTs compared to a partial month of amortization in 2012. These VLTs had a minimum lease period of either 12 or 18 months. The increase in 2012 from 2011 is attributed to a full year's worth of depreciation for the VLTs purchased in 2011 and one month's of amortization for certain VLTs leased at the casino that opened in June 2012.

Non-operating Expenses

Non-operating expenses increased by $241.5 million or 35.24% in 2013 compared to 2012 which increased $94.7 million or 16.04% compared to 2011. Non-operating expenses primarily consist of unrealized gains and losses on investments held to fund obligations to annuitants and payments to the State of Maryland General Fund, the Stadium Authority and Other Government Agencies.

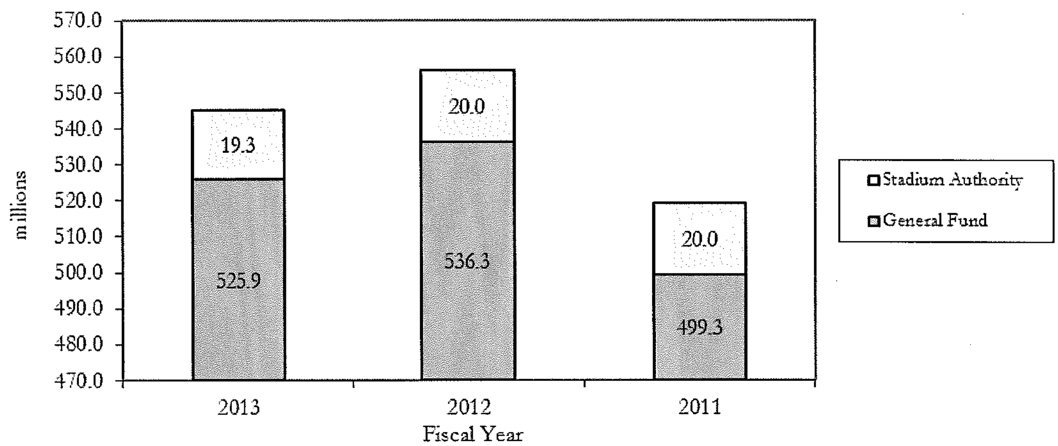
The MLGCA expects to realize the face value of its investments, since it intends to hold these investments until maturity. Therefore, any interim unrealized gains or losses on investments will reverse. The change in fair value of the investments held by the MLGCA is discussed in more detail beginning on page 33.

The MLGCA is required by State law to transfer its budgetary basis net income to the State of Maryland (General Fund and Stadium Authority) from its lottery operations. Furthermore, it is required to transfer revenue from its gaming operations to various government agencies. Accordingly, the MLGCA's success can be measured by the income it transfers.

Non-operating Expenses – (continued)

Transfers to the State of Maryland General Fund and Stadium Authority totaled $545.2 million in 2013, a decrease of $11 million or 1.98% compared to 2012 which increased $36.9 million or 7.38% compared to 2011. The decrease in 2013 from 2012 is the result of the decline in lottery sales and conversely, the increase in 2012 from 2011 is the result of an increase in lottery sales. The graph below depicts the payments made to the State of Maryland for 2013, 2012, and 2011.

Payments to the State of Maryland



Transfers to other government funds/agencies increased by $247.7 million in 2013 or 192.16% from 2012 which increased by $61.7 or 91.72% from 2011. Table 7 on page 16 provides a breakdown of the various accounts. Funds retained by the MLGCA are not included in the increases noted for non-operational expenses. The increase in 2013 is primarily attributed to a full year of operation for the Maryland Live! Casino (versus a partial month in 2012), the opening of the Rocky Gap Casino Resort and the debut of table games. The increase in 2012 from 2011 was attributed to a full year of operation for both Hollywood Casino – Perryville and the Casino at Ocean Downs (versus a partial year in 2011) and to a lesser extent, the opening of the Maryland Live! Casino in June 2012.

Contacting the Lottery's Financial Management

The financial report is designed to provide a general overview of the MLGCA's financial activity for those interested in the MLGCA's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to: Gina M. Smith, Deputy Director/CFO, Maryland Lottery and Gaming Control Agency, 1800 Washington Boulevard, Suite 330, Baltimore, Maryland 21230.

Maryland Lottery and Gaming Control Agency
Statements of Net Position
As of June 30, 2013 and 2012

	2013	2012
Assets:		
Current assets:		
Cash and cash equivalents	$ 2,267,343	$ 3,024,180
Cash and cash equivalents - Gaming Escrow	75,616,457	27,633,026
Cash and cash equivalents -Restricted-Gaming Licensing Deposits	1,324,050	605,632
Cash and cash equivalents - Agent	103,550	125,703
Cash held with State Treasury	84,922,096	86,593,206
Accounts receivable - Lottery	36,834,692	36,054,797
Accounts receivable - Gaming	7,916,886	5,412,100
Prepaid commissions	43,599	35,106
Current portion of investments for annuity payments	13,388,987	17,049,540
Total current assets	222,417,660	176,533,290
Non-current assets:		
Capital assets, net of accumulated depreciation and amortization	23,826,160	49,229,808
Investments for annuity payments, net of current portion	45,933,461	59,192,221
Total non-current assets	69,759,621	108,422,029
Total assets	$ 292,177,281	$ 284,955,319
Liabilities and Net Position:		
Current liabilities:		
Current portion of annuity prizes payable	$ 13,388,987	$ 16,453,027
Current portion of employee related payables	1,789,144	1,473,326
Current portion of capital lease obligations	14,110,640	25,909,450
Transfer due to State of Maryland General Fund	36,447,376	43,226,579
Transfer due to Other Government Agencies - Gaming	38,052,948	28,222,797
Prize awards payable	41,094,928	42,818,322
Accounts payable and accrued expenses	2,884,080	3,150,247
Accounts payable and accrued expenses - Gaming	4,155,859	1,589,418
Gaming Licensing Deposits	1,152,763	396,259
Gaming Escrow Payable	75,616,457	27,633,026
Agent Escrow Payable	103,550	125,703
Unearned revenue	2,362,764	2,684,438
Taxes and other liabilities	827,337	833,184
Total current liabilities	231,986,833	194,515,776
Non-current liabilities:		
Annuity prizes payable, net of current portion	37,783,258	47,406,876
Employee related payables, net of current portion	516,299	571,773
Capital lease obligations, net of current portion	16,912,542	30,303,350
Total non-current liabilities	55,212,099	78,281,999
Total liabilities	287,198,932	272,797,775
Commitments and Contingencies (Note 7)		
Net Position:		
Net investment in Capital Assets	(7,197,022)	(6,982,992)
Unrestricted	12,175,371	19,140,536
Total net position	4,978,349	12,157,544
Total liabilities and net position	$ 292,177,281	$ 284,955,319

The accompanying notes are an integral part of these financial statements.

Maryland Lottery and Gaming Control Agency
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2013 and 2012

	2013	2012
Sales:		
Draw games	$ 1,270,280,595	$ 1,288,088,749
Instant games	485,838,672	506,803,706
Total Sales	1,756,119,267	1,794,892,455
Gaming revenue - gross terminal revenue	560,679,031	195,093,073
Gaming revenue - state grant	73,690,820	28,959,177
Gaming revenue - table games	48,037,794	-
Gaming revenue - facility applicants	2,703,989	1,791,260
Gaming revenue - machine assessments	2,964,174	1,708,825
Total Revenue	2,444,195,075	2,022,444,790
Cost of sales:		
Prize expense	1,038,475,788	1,065,653,665
Retailer commissions	119,788,227	118,305,427
Casino commissions	223,930,473	64,380,714
Gaming vendor and data processing fees	21,368,102	20,077,153
Instant ticket printing and delivery	6,435,341	6,206,543
Total Cost of Sales	1,409,997,931	1,274,623,502
Gross Profit	1,034,197,144	747,821,288
Operating expenses:		
Salaries, wages and benefits	16,929,270	15,662,232
Advertising and promotions	13,297,155	12,592,589
Depreciation and amortization	25,403,648	10,817,070
Other general and administrative expenses	59,032,711	17,293,017
Total Operating Expenses	114,662,784	56,364,908
Income from Operations	919,534,360	691,456,380
Non-operating revenues (expenses):		
Investment revenue (loss)	(640,822)	5,438,482
Amortization of discount for annuity prize liabilities	(3,590,833)	(4,627,389)
Interest expense	(719,832)	(911,404)
Payments to State of Maryland General Fund	(525,960,121)	(536,264,804)
Payments to State of Maryland Stadium Authority	(19,265,000)	(20,000,000)
Payments to Other Governmental Funds/Agencies - Gaming	(376,536,947)	(128,881,213)
Total Non-Operating Expenses	(926,713,555)	(685,246,328)
Change in Net Position	(7,179,195)	6,210,052
Total Net Position - Beginning of Year	12,157,544	5,947,492
Total Net Position - End of Year	$ 4,978,349	$ 12,157,544

The accompanying notes are in integral part of these financial statements.

Maryland Lottery and Gaming Control Agency
Statements of Cash Flows
For the Years Ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Receipts from customers	$ 2,489,218,420	$ 2,037,011,327
Payments to suppliers	(96,022,934)	(61,320,753)
Payments to employees	(20,928,539)	(12,382,245)
Payments to agents	(341,242,754)	(184,179,986)
Prize payments/awards to players	(1,039,420,519)	(1,067,073,409)
Net cash and cash equivalents provided by operating activities	991,603,674	712,054,934
Cash flows from noncapital financing activities:		
Transfers to the State of Maryland General Fund and Stadium Authority	(552,005,563)	(594,497,091)
Transfers to Other Government Funds/Agencies-Gaming	(366,276,348)	(108,856,144)
Transfer from VLT Special Fund to General Fund	(376,061)	361,890
Prize payments/awards	(17,062,994)	(21,379,996)
Net cash and cash equivalents used in noncapital financing activities	(935,720,966)	(724,371,341)
Cash flows from capital and related financing activities:		
Payments of capital lease obligations	(25,189,618)	(10,286,806)
Interest payments	(719,832)	(796,621)
Net cash and cash equivalents used in capital and related financing activities	(25,909,450)	(11,083,427)
Cash flows from investing activities:		
Coupon bonds purchased	(784,505)	(742,734)
Proceeds from matured annuities and bonds	17,062,996	21,379,996
Net cash and cash equivalents provided by investing activities	16,278,491	20,637,262
Net increase (decrease) in cash and cash equivalents	46,251,749	(2,762,572)
Cash and cash equivalents, beginning of year	117,981,747	120,744,319
Cash and cash equivalents, end of year	$ 164,233,496	$ 117,981,747
Noncash investing and financing activities:		
Acquisition of equipment through capital lease	$ -	$ 21,613,167
Change in fair value of investments	$ (4,231,655)	$ 811,093

Maryland Lottery and Gaming Control Agency
Statements of Cash Flows - (continued)
For the Years Ended June 30, 2013 and 2012

	2013	2012
Reconciliation of operating income to net cash and cash equivalents provided by operating activities:		
Operating income	$ 919,534,360	$ 691,456,380
Adjustments to reconcile operating income to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	25,403,648	10,817,070
Deferred prize payments	784,505	742,734
Due to DHMH Problem Gaming Program	-	(1,708,825)
Effect of changes in operating assets and liabilities:		
Accounts receivable	(3,284,681)	(10,403,994)
Prepaid commissions	(8,493)	13,577
Accounts payable and accrued expenses	50,964,996	23,258,832
Employee related payables	260,344	243,228
Taxes and other liabilities	(5,847)	461,344
Prize awards payable	(1,723,394)	(2,629,135)
Unearned revenue	(321,764)	(196,277)
Net cash and cash equivalents provided by operating activities	$ 991,603,674	$ 712,054,934

The accompanying notes are an integral part of these financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Legislative Enactment

The Maryland Lottery and Gaming Control Agency (MLGCA) was established by the Maryland General Assembly enactment of Chapter 365 of Laws of Maryland of 1972, and the voters' approval that same year of a constitutional amendment to allow the lottery. The amendment was ratified on November 7, 1972, and the MLGCA commenced operations on January 2, 1973.

The mandate of the law was to establish a State-operated lottery, under the immediate supervision of a Director and the guidance of a Commission, for the purpose of producing revenue for the State. The Governor, with the advice and consent of the Senate of Maryland, appoints the Director and the Commission members.

During the 2007 special session of the Maryland General Assembly, Chapter 4 was enacted relating to the legalization of video lottery terminals (VLTs) in the State subject to the passage of a voters' constitutional referendum. In a 2008, voters approved the installation of up to 15,000 VLTs at five privately owned casinos at specified locations throughout the State.

On August 14, 2012, Senate Bill 1 – Gaming Expansion – Video Lottery Terminals and Table Games passed the 2012 Second Special Session of the Maryland General Assembly. This bill contained many provisions concerning gaming operations and certain provisions that were subject to voter referendum. The provisions which were subject to voter referendum passed during the November 6, 2012 election and allowed for a sixth casino at a site in Prince George's County, increased the maximum number of video lottery terminals allowed in the State from 15,000 to 16,500, established table games and allowed for 24-7 operations.

The MLGCA, in conjunction with its Commission, serves as the regulator of the gaming program and is responsible for regulating the casinos, licensing the casino operators and all other entities and individuals requiring a gaming license, the purchase or lease of all VLTs and the collection and disbursement of VLT gross terminal revenue and table game revenue in accordance the law.

The MLGCA is a part of the primary government of the State of Maryland and is reported as a proprietary fund and business-type activity within the State of Maryland's financial statements. The State of Maryland prepares a comprehensive annual financial report (CAFR). The MLGCA is an enterprise fund of the State of Maryland and is included in the basic financial statements of the CAFR of the State of Maryland.

Basis of Accounting and Presentation

The MLGCA is accounted for as a proprietary special purpose government fund engaged in business-type activities. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and with accounting principles generally accepted in the United States of America, the financial statements are prepared on the accrual basis of accounting which requires recognition of revenue when earned and expenses when incurred. As permitted by GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the MLGCA has elected to not adopt Financial Accounting Standard Board (FASB) statements and interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB statements or interpretations.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates.

Lottery Games– Revenue Recognition and Prize Obligations

Revenue from lottery games originate from two product lines: draw games and instant games. The MLGCA develops multiple game themes and prize structures to comply with its enabling legislation and customer demand. Independent and corporate retailers comprised principally of grocery and convenience stores, package goods stores, and restaurants serve as the primary distribution channel for draw and instant lottery sales. Retailers also cash winning tickets up to certain dollar amounts. Prior to January 1, 2013, retailers earned a 5% sales commission. Effective January 1, 2013, the sales commission increased to 5 ½%. For the years ended June 30, 2013 and 2012, retailers received a cashing commission of 3% of prizes redeemed in their establishment.

Licensed lottery agents sell draw game lottery tickets to the public through the use of computerized terminals. Draw games are categorized as: Numbers (Pick 3 and Pick 4), Matrix (Multi-Match, Mega Millions/MegaPlier, Powerball/Powerplay, Bonus Match 5 and 5 Card Cash) and Monitors (Keno, Keno Bonus®, Keno Super Bonus, Racetrax®, and Racetrax® Bonus.) Draw revenue is recognized in the month in which the related drawings are held. Revenue from the sale of tickets and commissions paid for future drawings are deferred until the drawings are held and is reported as unearned revenue on the accompanying statements of net position. Revenue from instant games is recognized when the retailer activates the book of tickets.

Prize obligations for draw games are determined and recognized after each drawing is held. For all draw games, winners are paid a certain amount depending upon the number of winners and the order of the winning numbers drawn. The Multi-Match, Mega Millions and Powerball jackpots are calculated as a percentage of total game revenue. If there is not a jackpot winner, the prize pool is carried forward until there is a winner. The remaining Multi-Match, Mega Millions and Powerball prize levels are based on a predetermined set amount. Prize obligations are recognized monthly for instant games based on the books activated by retailers and the related prize expense based on the specific game's prize structure.

Gaming Operations (VLTs and Table Games) - Revenue Recognition and Prize Obligations

As of the end of fiscal year 2013, four casinos were in operation with a total of 5,471 VLTs. VLTs are a self-activated video version of lottery games which allow for a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The prize structures of these video lottery games are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expenses are netted against total video credits played. The MLGCA recognizes VLT revenue as "gross terminal revenue" equivalent to all wagers, net of related prizes.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Gaming Operations (VLTs and Table Games) - Revenue Recognition and Prize Obligations – (continued)

In accordance with the law, three of the casino operators receive 33% of the gross terminal revenue to operate their casinos, while the fourth casino operator receives 50% of the gross terminal revenue. Prior to October 1, 2012, the enabling legislation required the MLGCA to collect 100% of the gross terminal revenue and then return the casino operators share. Effective, October 1, 2012, the enabling legislation allowed the casino operators to retain their share of the gross terminal revenue. During fiscal year 2012, the casino operators share was classified as an operating expense. For fiscal year 2013, the casino operators share is classified as cost of sales and accordingly, the fiscal year 2012 casino operators share has been reclassified. The MLGCA retains 2% of the gross terminal revenue to help fund the operations of the VLT program. The enabling legislation requires the MLGCA to disburse the remainder of the gross terminal revenue to other government agencies, which in turn are responsible for making further distributions.

On March 6, 2013, table games opened at one of the casinos. By the end of fiscal year 2013, there were 154 table games in operation at three of the casinos. Table games include blackjack, roulette, craps and various poker games. Table game revenue is equivalent to all wagers, net of related prizes. Casino operators receive 80% of the table game revenue to operate their casino. These costs are recorded as cost of sales. The remaining 20% is remitted to the MLGCA who in turn transfers it to the Education Trust Fund in accordance with the enabling legislation.

To further help fund the operations of the gaming program, the State provided grants to the MLGCA during fiscal years 2013 and 2012 in the amount of $73,690,820 and $28,959,177, respectively.

Administrative expenses for the gaming program are recognized as they are incurred. The majority of the expenses incurred for the VLT program are for the purchase and lease of the VLTs. VLTs that were purchased by the MLGCA were financed through the State Treasurer's Office and are treated as a capital lease for financial statement purposes. The leased VLTs are comprised of VLTs that have no minimum lease period or VLTs that have a minimum lease period of 12 or 18 months. For the VLTs that do not have a minimum lease period, the MLGCA treats these payments as an administrative expense and recognizes the expense when incurred. For the VLTs that have a minimum lease period, the majority of them meets the criteria for capital leases and are treated as such for financial statement purposes.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses for proprietary funds such as the MLGCA are revenues and expenses that result from providing services and producing and delivering goods and/or services. Operating revenues for the MLGCA are derived from providing various types of lottery games, VLT games and table games. Operating expenses for lottery games include the costs to operate the various games, pay prize winners, and administrative expenses. Operating expenses for gaming operations include the costs to operate the various games and administrative expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and Cash Equivalents

Cash and cash equivalents include cash deposited with financial institutions, deposits with the Maryland State Treasury, and overnight investments in repurchase agreements.

Cash and Cash Equivalents – Gaming Escrow

Cash and Cash Equivalents – Gaming Escrow consists of funds deposited in escrow with a financial institution and the related interest earned. The monies deposited are primarily application fees received from casino operator license applicants that are held in separate escrow sub accounts until the application review process is complete and the license is either awarded or denied. If the license is awarded, the monies being held are transferred to the Education Trust Fund of the State of Maryland. If the license is denied, the monies received are returned to the applicant. During fiscal year 2013, the MLGCA received $53,100,000 in application fees from three bidders interested in bidding on the sixth casino location in Prince George's County. During fiscal year 2013, the MLGCA transferred $2,100,000 to the Education Trust Fund after the award for the Rocky Gap Casino Resort and transferred $2,798,798 to the court systems for an unsuccessful bidder in Baltimore City.

Secondarily, the account is used to facilitate the receipt of other license fees that are received from applicants wanting to obtain a gaming license from the MLGCA. The total amount of the fees received varies based on the type of license to be issued. Such amounts are temporarily deposited into a separate Gaming Escrow sub account and are subsequently withdrawn and deposited into the Gaming Special Fund account that is held by the State Treasurer. Amounts remaining in the escrow accounts are generally small at month end.

Cash and Cash Equivalents – Restricted – Gaming Licensing Deposits

Cash and Cash Equivalents – Restricted – Gaming Licensing Deposits account is used to record the receipt of license related fees and investigation deposits that are received from applicants wanting to obtain a gaming license. Under the law, the MLGCA is charged with issuing the following licenses: manufacturer, contractor, vendor, principal employee, gaming employee and non-gaming employee.

For gaming and non-gaming license applicants, the MLGCA receives the following fees: application, license and fingerprint to help cover the costs of licensing these applicants. All of these types of fees are recorded as revenue after the specific applicant and type of fee received is determined. At the end of each month, these fees are transferred to the Gaming Special Fund account.

For principal employee applicants, in addition to the aforementioned fees, the MLGCA also receives a background investigation deposit which is used to pay the investigation costs for the principal employee applicant. These deposit amounts remain in Cash and Cash Equivalents – Restricted – Gaming Licensing Deposits and are recorded as a licensing deposit liability until the investigation is completed. To the extent that the investigation deposit is greater than the costs incurred for the investigation, the monies are refunded to the applicant. To the extent that the investigation deposit is less than the costs incurred for the investigation, the applicant is billed for the deficit. After the investigation is completed, the deposit is recorded as revenue and is transferred to the Gaming Special Fund account.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and Cash Equivalents – Agent

Cash and Cash Equivalents – Agent consists of funds deposited in escrow with a financial institution and the related interest earned. Monies deposited into the escrow accounts were received from select agents who deposited monies with the MLGCA in lieu of obtaining a bond.

Accounts Receivable - Lottery

Accounts receivable represents the amounts due from lottery retailers from the sale of lottery tickets. The MLGCA utilizes the allowance method to provide for doubtful accounts based on management's evaluation of the collectability of accounts receivable. The MLGCA determines accounts receivable to be delinquent when greater than 10 days past due. Receivables are written off when it is determined that amounts are uncollectible. As of June 30, 2013 and 2012, management believes all accounts receivable - lottery are collectible, and, as such, no allowance for doubtful accounts has been recorded.

Accounts Receivable – Gaming

Accounts Receivable – Gaming applicants represent outstanding amounts due that have been billed to applicants for completed background investigations and amounts due from VLT manufacturers for liquidated damages.

In addition, this amount includes the amount of gross terminal revenue and table game revenue due from the casino operators. Gross terminal revenue is collected on a daily basis. Also included in the June 2013 balance is the amount due from the casino operators for the $425 VLT assessment and the $500 table game assessment that is due to the Problem Gaming Fund. Management believes that all accounts receivable – gaming are collectable, and as such, no allowance for doubtful accounts has been recorded.

Capital Assets

The MLGCA has adopted a policy of capitalizing assets with individual amounts exceeding $25,000 and all leased assets. These assets are comprised principally of technology equipment necessary to administer lottery games and VLTs. The purchased assets are recorded at cost and depreciation is computed using the straight-line method over three-to-five year useful lives. Assets acquired through capital leases are initially recorded at the lower of fair value at the date of the lease or the net present value of the minimum lease payments. Assets acquired under capital leases are amortized over the lesser of the lease term or the estimated useful life of the leased asset.

Investments for Annuity Payments

Investments consist of United States Government Treasury Bonds and annuity contracts. The investments in United States Government Treasury Bonds are purchased in the name of the MLGCA and stated at fair value based on quoted market prices of similar instruments. Investments in annuity contracts are purchased in the name of the MLGCA and stated at present value, which approximates fair value.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Compensated Absences

The MLGCA accrues compensated absences in accordance with GASB No. 16, *Accounting for Compensated Absences*. All full-time permanent MLGCA employees accrue annual leave at variable rates based on the number of years employed by the State of Maryland. The maximum annual leave an employee can earn per calendar year is 25 days. At the end of each calendar year, an employee's accrued annual leave may not exceed 75 days. Accrued annual leave is included in the employee related payables in the accompanying statements of net position. All full-time permanent MLGCA employees also accrue sick pay benefits. However, the MLGCA does not record a liability for accrued sick pay benefits as neither the State of Maryland nor the MLGCA has a policy to pay unused sick leave when employees terminate from State service.

Payments to the State of Maryland

The law requires the MLGCA to transfer its lottery revenue in excess of funds allocated to prize awards, operating expenses, and the Maryland Stadium Authority to the State of Maryland General Fund. The income from operations of the Mega Millions game is transferred to the Maryland Stadium Authority up to an annual cap set by the authorized appropriation. These payments are recorded as a non-operating expense in the accompanying statements of revenues, expenses, and changes in net position.

The law further requires the MLGCA to transfer its gaming revenue to various governmental agencies. In addition to the required transfers, the MLGCA retains 2% of the gross terminal revenue to help fund the costs of operations, three of the casinos receive 33% of the gross terminal revenue and one of the casinos receives 50% of the gross terminal revenue to help fund the costs of their operations, and all casinos receive 80% of the table game revenue to help fund the costs of their operations.

On a monthly basis, the MLGCA transfers these funds as follows:

- A transfer of 5.5% of the gross terminal revenue is made to the State's Racing Commission into an account for local impact grants.

- A transfer of 7% of the gross terminal revenue, not to exceed a total of $100 million annually, is made to the State's Racing Commission into the Purse Dedication Account.

- Prior to October 1, 2102, a transfer of 2.5% of the gross terminal revenue, not to exceed a total of $40 million annually, was made to the State's Racing Commission into the Racetrack Facility Renewal Account. Effective October 1, 2012, this percentage was reduced to 1.5%.

- A transfer of 1.5% of the gross terminal revenue is transferred to the State's Board of Public Works into the Small, Minority, and Women-Owned Businesses Account.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Payments to the State of Maryland – (continued)

- A transfer is made to the State's Department of Education into the Education Trust Fund. The transfer amount for the gross terminal revenue varied during fiscal year 2013 as this fund receives the remainder of the gross terminal revenue after all other transfers have been made. The decrease in the contribution to the Racetrack Facility Renewal Account increased the overall amount transferred to the Education Trust Fund, while the 50% retained by the one casino versus the 33% retained by the other casinos decreased the amount transferred. For fiscal year 2013, the Education Trust Fund received 46.7% of the gross terminal revenue. In addition to a percentage of gross terminal revenue, the Education Trust Fund received 20% of the table game revenue.

These transfers are recorded as non-operating expenses in the accompanying statements of revenues, expenses and change in net position.

A summary of the total game revenue and the distributions for the years ended June 30, 2013 and 2012, respectively follows:

Distribution	Fiscal Year 2013 Amount	Fiscal Year 2012 Amount
Education Trust Fund	**$ 284,521,586**	**$94,620,140**
Local Impact Grants	**30,760,321**	**10,730,119**
Purse Dedication	**39,121,491**	**13,656,515**
Racetracks Facility Renewal	**10,780,196**	**4,877,327**
Small, Minority and Women Owned Businesses	**8,389,179**	**2,926,396**
Maryland Lottery and Gaming Control Agency	**11,213,581**	**3,901,862**
Casino Operators	**223,930,473**	**64,380,714**
Total	**$ 608,716,827**	**$195,093,073**

Restricted Assets

State law restricts the MLGCA's assets in their entirety. The MLGCA's assets are not reported as restricted on the statements of net assets since the restriction created by State law is as broad as the MLGCA's operations.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Position

Net position is presented as either unrestricted or net investment in capital assets. Net investment in capital assets represents the difference between capital assets net of accumulated depreciation and amortization and the related capital lease obligations. Unrestricted net assets represent the net assets available for future operations including outstanding encumbrances as of year-end and unrealized gains or losses on investments. Market gains or losses represent temporary fluctuations and are not recognized in the calculation of the amount due to the Maryland Stadium Authority, State of Maryland General Fund or payments to Other Governmental Agencies.

New Accounting Pronouncements

The MLGCA has implemented GASB Statement No. 61, *The Financial Reporting Entity: Omnibus-and amendment of GASB Statements No. 14 and No. 34*, GASB Statement No 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* and GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53* for the fiscal year ended June 30, 2013. None of these statements had a material impact of the MLGCA's financial position; however, GASB Statement No. 63 did require the renaming of net assets to net position.

GASB has issued Statement No 65, *Items Previously Reported as Assets and Liabilities* and GASB Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62* effective for periods beginning after December 15, 2012. GASB has also issued Statement No. 67 *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25* and GASB Statement No. 70 *Accounting and Financial Reporting for Nonexchange Financial Guarantees* effective for reporting periods beginning after June 15, 2013. GASB Statement No. 69, *Government Combinations and Disposals of Government Operations,* has been issued for reporting periods effective after December 15, 2013 and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* has been issued for reporting periods effective after June 15, 2014. The MLGCA is in the process of assessing the impact of these statements and will implement them as of the effective dates.

Reclassification

Certain amounts presented in the 2012 financial statements have been reclassified to conform to the 2013 presentation.

2. CASH AND CASH EQUIVALENTS

As of June 30, 2013 and June 30, 2012, the carrying amounts of deposits with financial institutions were $79,311,400 and $31,388,541, respectively. The corresponding bank balances were $78,774,408 and $30,863,211 as of June 30, 2013 and June 30, 2012, respectively.

As of June 30, 2013 and June 30, 2012, the amount on deposit with the Maryland State Treasury was $84,922,096 and $86,593,206, respectively. The corresponding Maryland State Treasury balances were $12,688,352 and 16,859,587, respectively. The State Treasury has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards, and commissions. The deposits with the State Treasury are part of the State of Maryland's internal investment pool and are not separately identifiable as to specific types of securities. The Treasury maintains these and other Maryland State agency funds on a pooled basis in accordance with State statute. The MLGCA does not obtain interest on funds deposited with the State Treasury. As of June 30, 2013 and 2012, the MLGCA's deposits with the State Treasury were less than 2% of the total deposits with the State Treasury.

Custodial credit risk – Custodial credit risk is the risk that in the event of a bank failure, the MLGCA's deposits will not be returned to it. The MLGCA's deposit policy requires that it comply with the State law that governs the State Treasury deposits. Specifically, unexpended or surplus money may be deposited in a financial institution in the State, if the deposit is interest bearing; the financial institution provides collateral that has a market value that exceeds the amount by which a deposit exceeds the deposit insurance; and the custodian holds the collateral.

Federal depository insurance covers a portion of the MLGCA's deposits with a financial institution, and the remaining balance is collateralized with securities that are held by the State of Maryland's agent in the State's name. These deposits are invested in overnight repurchase agreements. As of June 30, 2013 and 2012, the collateral for the repurchase agreements were Federal National Mortgage Association (FNMA) Mortgage-Backed Securities which are not rated; however, the amount of collateral meets or exceeds the deposit insurance.

Interest rate risk – The State Treasury investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the State Treasury will not directly invest in securities maturing more than five years from the date of purchase.

Credit risk – State law requires that the State Treasury investments in repurchase agreements be collateralized by United States Treasury and Agency Obligations. In addition, investments may be made directly in United States Agency Obligations. State law also requires that money market mutual funds receive the highest possible rating from at least one nationally recognized statistical rating organization.

Concentration of credit risk – The State Treasury's investment policy limits the amount of repurchase agreements to be invested with a particular institution to 30% of the portfolio. There is no other limit on the amount that may be invested in any one issuer. More than 5% of government funds investments are in the FNMA and the Federal Home Loan Mortgage Corporation. As of June 30, 2013, these investments are 38.99% and 35.02% of the State of Maryland's internal investment pool total investments, respectively. As of June 30, 2012, these investments were 40.54% and 46.35% of the State of Maryland's internal investment pool total investments, respectively.

3. INVESTMENTS

United States Government Treasury Bonds

It is the MLGCA's policy to fund jackpot and lifetime prize awards through the purchase of United States Government Treasury Bonds. Furthermore, it is the policy of the MLGCA to hold these investments to maturity. The investment maturities approximate the annuity prizes payable installment due dates.

The MLGCA has purchased long-term investments to fund jackpot and lifetime prize awards. The majority of these investments are United States Government Treasury Bonds, which carry a yield to maturity of approximately .173% to 8.4%. As of June 30, 2013 and June 30, 2012, the MLGCA's United States Government Treasury Bonds totaled $59,094,730 and $75,972,649 respectively. The investments in United States Government Treasury Bonds are carried at fair value based on quoted market prices on the accompanying statements of net position and the related unrealized gains (losses) and interest income are recorded as investment revenue (loss) on the accompanying statements of revenues, expenses, and changes in net position.

Through the State securities lending program, authorized under section 2-603 of the State's Finance and Procurement Article of the Annotated Code of Maryland, the State Treasurer's Office lends United States Government securities to broker-dealers and other entities (borrowers). As of June 30, 2013 and June 30, 2012, MLGCA United States Government Treasury Bonds totaling $33,908,243 and $59,688,802, respectively, were lent as part of this program. The State Treasurer's Office controls the program and authorizes all transactions. The State's (and MLGCA's) custodial bank manages the securities lending program by contracting with a lending agent who receives cash as collateral. The lending agent may use or invest cash collateral in accordance with the reinvestment guidelines approved by the State Treasurer's Office. Additionally, under the terms of the lending agreement, the lending agent indemnifies the State against any credit loss arising from investment of the collateral. The collateral will be returned for the same securities by the next business day if the aggregate value of the collateral falls to less than 100% of the market value of the securities lent against the collateral. Cash collateral is initially pledged at greater than the market value of the securities.

At year-end, the State has no credit risk exposure to borrowers because the amounts the State owes the borrowers exceed the amounts the borrowers owe the State. As of June 30, 2013 and 2012, the related collateral for the MLGCA securities lent totaled $34,651,503 and $60,940,096, respectively, resulting in 102.2% as of June 30, 2013 and 2012 collateralization of the fair value of the MLGCA securities lent. The benefit of collateral received or income earned is not passed onto the MLGCA and therefore not reflected in the MLGCA's financial statements.

Either the State or the borrower may terminate the lending agreements on demand. Lending agreements are usually short in duration. The duration of the lending agreements is matched with the term to maturity of the investment of the cash collateral by investing only in repurchase agreements. Such matching existed at year-end. The State's custodial bank is obligated to indemnify the State against liability for any suits, actions, or claim of any character arising from or relating to the performance of the bank under the contract, except for liability caused by acts or omissions of the State. The State did not experience any losses on their securities lending transactions for the years ended June 30, 2013 and 2012.

3. INVESTMENTS - (continued)

Annuity Contracts

Certain investments are held in annuity contracts that return guaranteed interest ranging from 7.6% to 12.1%. As of June 30, 2013 and June 30, 2012, the annuity contracts totaled $227,718 and $269,112, respectively. The annuity contracts were purchased in 1976 to satisfy the MLGCA's obligation for certain lifetime prizes. The value of the annuity contracts and related annuity prizes payable were adjusted in fiscal year 2005 based on revised actuarial life expectancy tables.

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The MLGCA is not subject to interest rate risk because it is the MLGCA's policy to hold the investments until maturity, unless an annuitant through a court order forces the sale of an investment to settle the MLGCA's obligation to the annuitant at which time the annuitant would be paid the proceeds received from the sale of the investments.

3. INVESTMENTS - (continued)

For an investment, custodial risk is the risk that in the event of the failure of the counterparty, the MLGCA will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The MLGCA is not subject to custodial risk because the United States Government Treasury Bonds are held in the MLGCA's name by its custodian and annuity contracts are not evidenced by securities that exist in physical or book entry form.

As of June 30, 2013, the MLGCA had the following investments:

Investment Type	Fair Value	Credit Quality Rating	% of Investments	Investment Maturities (In Years) Less than 1	1-5	6-10	11-20	21-30
Investments in prize annuities:								
United States Treasury Bonds	$59,094,730	1	99.6%	$13,783,996	$25,054,101	14,259,691	$5,996,942	$ -
Annuity Contracts	227,718	2	.4%	50,970	140,320	19,729	16,699	-
Total Investments	$59,322,448		100.0%	$13,834,966	$25,194,421	$14,279,420	$6,013,641	$ -

1 Credit quality ratings not required for U.S. government and agency securities that are explicitly guaranteed by the U.S. government.
2 Annuity contracts not rated.

As of June 30, 2012, the MLGCA had the following investments:

Investment Type	Fair Value	Credit Quality Rating	% of Investments	Investment Maturities (In Years) Less than 1	1-5	6-10	11-20	21-30
Investments in prize annuities:								
United States Treasury Bonds	$75,972,649	1	99.6%	$16,998,433	$35,627,323	$15,153,372	$8,193,521	$ -
Annuity Contracts	269,112	2	.4%	51,107	164,187	35,079	18,739	-
Total Investments	$76,241,761		100.0%	$17,049,540	$35,791,510	$15,188,451	$8,212,260	$ -

1 Credit quality ratings not required for U.S. government and agency securities that are explicitly guaranteed by the U.S. government.
2 Annuity contracts not rated.

4. CAPITAL ASSETS

A summary of capital asset activity for the years ended June 30, 2013 and 2012 is as follows:

	2012	Increases	Decreases	2013
Capital Assets				
Machinery and Equipment	$70,126,934	$ -	$ -	$70,126,934
Leasehold Improvements	613,240	-	-	613,240
Total Capital Assets	70,740,174	-	-	70,740,174
Less Accumulated Depreciation and Amortization				
Machinery and Equipment	20,922,675	25,378,097	-	46,300,772
Leasehold Improvements	587,691	25,551	-	613,2432
Total Accumulated Depreciation and Amortization	21,510,366	25,403,648	-	46,914,014
Net Capital Assets	$49,229,808	$25,403,648	$ -	$23,826,160

	2011	Increases	Decreases	2012
Capital Assets				
Machinery and Equipment	$48,513,767	$ 21,613,167	$ -	$70,126,934
Leasehold Improvements	613,240	-	-	613,240
Total Capital Assets	49,127,007	$21,613,167	-	70,740,174
Less Accumulated Depreciation and Amortization				
Machinery and Equipment	10,166,930	10,755,745	-	20,922,675
Leasehold Improvements	526,366	61,325	-	587,691
Total Accumulated Depreciation and Amortization	10,693,296	10,817,070	-	21,510,366
Net Capital Assets	$38,433,711	$ 10,796,097	$ -	$49,229,808

5. ANNUITY PRIZE OBLIGATIONS

The MLGCA carries long-term annuity prize obligations at present value. Presented below is a summary of long-term annuity prize payment requirements for annuities payable to maturity:

Fiscal Year	Principal	Interest	Total
2014	$ 13,388,987	$ 455,009	$ 13,843,996
2015	9,795,318	961,678	10,756,996
2016	6,298,025	1,044,134	7,342,159
2017	3,683,065	802,927	4,485,992
2018	2,366,658	659,334	3,025,992
2019-2023	11,000,182	5,718,327	16,718,509
2024-2028	4,161,852	3,670,128	7,831,980
2029-2031	478,158	448,667	926,825
Total	$ 51,172,245	$ 13,760,204	$ 64,932,449

This debt represents annual payments owed to jackpot and lifetime winners. Annuity prizes are paid over a period of time ranging from 20 to 25 years depending on the time period in which the prize was won. The MLGCA has purchased United States Government Treasury Bonds or annuity contracts that fully fund these obligations.

Long-term liability activity of annuity prize payments for the years ended June 30, 2013 and 2012 was as follows:

Fiscal Year Ending	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
June 30, 2013	$63,859,903	$4,375,338	$17,062,996	$51,172,245	$13,388,987
June 30, 2012	$79,869,776	$5,370,123	$21,379,996	$63,859,903	$16,453,027

6. EMPLOYEE RELATED PAYABLES

Changes in long-term employee related payables were as follows for the years ended June 30, 2013 and 2012. The employee related payables due within one year are included in the current portion of the employee related payables on the accompanying statements of net position, which also includes salaries payable in the amount of $942,289 and $749,766 as of June 30, 2013 and 2012, respectively.

	2013		
	Compensated Absences	Workers' Compensation	Combined
Beginning Balance	$ 1,143,333	$ 152,000	$ 1,295,333
Additions	825,097	25,056	850,153
Reductions	(746,276)	(36,056)	(782,332)
Ending Balance	$ 1,222,154	$ 141,000	$ 1,363,154
Amount Due Within One Year	$ 825,000	$ 21,855	$ 846,855
Non-Current Portion	397,154	119,145	516,299
	$ 1,222,154	$ 141,000	$ 1,363,154

	2012		
	Compensated Absences	Workers' Compensation	Combined
Beginning Balance	$ 1,071,930	$ 185,921	$ 1,257,851
Additions	798,075	(28,374)	769,701
Reductions	(726,672)	(5,547)	(732,219)
Ending Balance	$ 1,143,333	$ 152,000	$ 1,295,333
Amount Due Within One Year	$ 700,000	$ 23,560	$ 723,560
Non-Current Portion	443,333	128,440	571,773
	$ 1,143,333	$ 152,000	$ 1,295,333

7. COMMITMENTS AND CONTINGENCIES

Leases

The MLGCA leases office space, warehouse facilities, and on-line and instant product equipment over periods extending through July 2023. Rent expense for each of the years ended June 30, 2013 and 2012 totaled $736,079 and $650,323 respectively. Certain leases contain a bargain purchase option and are accounted for as capital leases.

7. COMMITMENTS AND CONTINGENIES – (continued)

Leases – (continued)

The assets acquired under capital leases include:

	June 30, 2013	June 30, 2012
Machinery and Equipment	$68,286,448	$68,286,448
Accumulated Amortization	(44,717,774)	(19,425,506)
	$23,568,674	$48,860,942

The following is a schedule of future minimum lease payments under these leases:

Year Ending June 30,:	Operating Leases	Capital Leases
2014	$ 752,800	$14,110,640
2015	782,912	9,286,893
2016	814,228	8,679,860
2017	846,798	-
2018	880,669	-
2019	915,897	-
2020	952,532	-
2021	990,633	-
2022	1,030,259	-
2023	530,533	-
Total	$ 8,497,261	32,077,393
Less amount representing interest		1,054,211
Present value of minimum lease payments		31,023,182
Less current maturities		14,110,640
Long-term portion of capital lease obligations		$16,912,542

Liability activity for capital leases was as follows for the years ended June 30:

	2013	2012
Beginning Balance	$ 56,212,800	$44,886,439
Acquisitions	-	21,613,167
Payments	(25,189,618)	(10,286,806)
Ending Balance	$ 31,023,182	$ 56,212,800

Contracts

As of June 30, 2013, the MLGCA has entered into various contracts totaling approximately $400,002,248 for services to be rendered. These services relate principally to the operation of, and advertising for, lottery games and the operation of the gaming program.

8. PARTICIPATION IN MULTI-STATE GAMES – MEGA MILLIONS AND POWERBALL

Contracts – (continued)

The MLGCA is a member of the multi-state game Mega Millions. Mega Millions is a lottery game conducted as a cooperative venture by 13 states: Georgia, Illinois, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, Washington, California, Florida and Maryland. Effective January 31, 2010, 23 Powerball lotteries began selling the Mega Millions game. Currently, 45 jurisdictions sell the Mega Millions game. Also on January 31, 2010, the MLGCA began selling the Powerball game. Powerball is a lottery game currently sold by 45 lotteries. The Mega Millions states have agreed to a common set of game rules for both Mega Millions and Powerball and share in a common prize pool for each game. The prize pools are shared on a percent of sales basis. Game accounting is conducted after each semi-weekly drawing. Settlements between the states occur after each jackpot win and annually for all other prizes, unless a state's non-jackpot prize settlement amount exceeds $1,500,000, at which time the states conduct a mid-year settlement. Settlements occur annually for unclaimed non-jackpot prizes and after the claiming period have expired for unclaimed jackpot prizes.

9. RETIREMENT BENEFITS

The MLGCA and its employees contribute to the State Retirement and Pension System (the System). The System is a cost sharing multiple-employer public employee retirement system established by the State to provide pension benefits for State employees. The MLGCA's only obligation to the System is its required annual contribution. The System is administered by a Board of Trustees in accordance with State Personnel and the Pension Article of the Annotated Code of Maryland. The System prepares a separately audited CAFR, which can be obtained from the State Retirement and Pension System of Maryland, 120 East Baltimore Street, Baltimore, Maryland 21202.

Plan Descriptions

MLGCA employees are members of the Employees' Retirement and Pension Systems (two of several systems managed by the System's Board of Trustees). The Employees' Retirement System (the Retirement Plan) includes those employees hired prior to January 1, 1980 who have not elected to transfer to the Employees' Pension System (the Pension Plan). Conversely, members of the Pension Plan include those employees hired after January 1, 1980 and prior employees who have elected to transfer from the Retirement Plan. Changes were made to the Pension Plan that impact both existing members and new hires on or after July 1, 2011 differently. These changes are described in more detail below.

The Retirement Plan provides retirement, death, and disability benefits to its members. Members of the Retirement Plan are generally eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 30 years of eligible service regardless of age. The annual retirement allowance equals 1/55 (1.8%) of the member's highest three-year average final salary (AFS) multiplied by the number of years of accumulated creditable service. A member may retire with reduced benefits after completing 25 years of eligible service. Benefits are reduced by 0.5% per month for each month remaining until the retiree either attains age 60 or would have accumulated 30 years of eligible service, whichever is less. The maximum reduction for a member is 30%. Any member who terminates employment before attaining retirement age but after accumulating five years of eligible service is eligible for a vested retirement allowance.

9. RETIREMENT BENEFITS – (continued)

Plan Descriptions (continued)

The Pension Plan provides retirement, death and disability benefits to its members. Certain aspects of eligibility and benefit calculations are different for employees hired on or after July 1, 2011. Those differences are explained below.

Members of the Pension Plan who were active participants prior to July 1, 2011 are generally eligible for full retirement benefits upon the earlier of attaining age 62, with specified years of eligibility service, or accumulating 30 years of eligibility service regardless of age. Generally, the annual pension allowance for a member equals 1/55 (1.8%) of the member's AFS, multiplied by the number of years of creditable service. A member may retire with reduced benefits upon attaining age 55 with at least 15 years of eligible service. Any member who terminates employment before attaining retirement age but after accumulating five years of eligible service is eligible for a vested retirement allowance.

Employees hired on or after July 1, 2011 ("New Hires") are generally eligible for full retirement benefits based upon the "Rule of 90" which states that the sum of the employee's age plus eligible service must equal 90 or the employee must be age 65 with 10 years of service. The annual pension allowance for New Hires equals 1.5% of the member's AFS, multiplied by the number of years of creditable service. AFS for New Hires is calculated using the highest 5 consecutive years. A New Hire may retire with reduced benefits upon attaining age 60 with at least 15 years of eligible service. A New Hire who terminates employment before attaining retirement age but after accumulating ten years of eligible service is eligible for a vested retirement allowance.

Funding Policy

Active members and the employers of the members are required to contribute to the Employees' Retirement and Pension Systems. The MLGCA's required contribution is established by annual actuarial valuations using the entry age normal cost method with projection and other actuarial assumptions adopted by the Board of Trustees. For service earned after July 1, 2011, members of the Employees' Retirement System and the Employee's Pension System are required to contribute 7% of earnable compensation.

The MLGCA contributions, which equal 100% of the required contributions, for the three years ended June 30, 2013, 2012, and 2011 are as follows:

	2013	2012	2011
MLGCA contribution	$1,509,065	$1,222,917	$1,139,690
Percentage of payroll	9.04%	7.92%	7.88%

10. OTHER POSTEMPLOMENT BENEFITS

Funding Policy – (continued)

Members of the State Retirement and Pension Systems and their dependents are provided postemployment health care benefits through the State Employee and Retiree Health and Welfare Benefits Program (Plan). The Plan is a single-employer defined benefit health care plan established by the State Personnel and Pensions Article, Section 2-501 through 2-516 of the Annotated Code of Maryland. The Plan is self-insured to provide medical, hospitalization, prescription drug and dental insurance benefits to eligible state employees, retirees, and their dependents. A separate valuation is not performed for the MLGCA. The MLGCA's only obligation to the Plan is its required annual contribution.

Effective June 1, 2004, the State established the Postretirement Health Benefits Trust Fund (OPEB Trust) to receive appropriated funds and contributions to assist the Plan in financing the State's post-employment health insurance subsidy. The OPEB Trust is established in accordance with the State Personnel and Pensions Article, Section 34-101 of the Annotated Code of Maryland and is administered by the Board of Trustees for the State Retirement and Pension System. The Board of Trustees prepares a financial report for the OPEB Trust, which can be obtained from the State Retirement and Pension System of Maryland, 120 E. Baltimore Street, Suite 1600, Baltimore, Maryland 21202.

Plan Description

MLGCA employees are members of the Plan. Members, generally, may enroll and participate in the health benefit options if the retiree ended State service with at least 10 years of creditable service and within five years before the age at which a vested retirement allowance normally would begin or if the retiree ended State service with at least 16 years of creditable service.

Funding Policy

Beginning in fiscal year 2008, State law requires the State's Department of Budget and Management to transfer any subsidy received as a result of the Federal Medicare Prescription Drug Improvement and Modernization Act of 2003 or similar subsidy to the OPEB Trust to prefund OPEB benefits. To further prefund benefits, during fiscal year 2008, the State transferred funds from the State Reserve Fund Dedicated Purpose Account. Additionally, the State is required by law to provide funding each year for the Plan for the State's share of the pay-as-you-go amount necessary to provide current benefits to active and retired employees and their dependents. Funds may also be separately appropriated in the State's budget for transfer to the OPEB Trust.

Based on current practice, the State subsidizes approximately 50% to 85% of covered medical, dental, prescription, and hospitalization costs, depending on the type of insurance plan. The State assesses a surcharge for postemployment health care benefits, which is based on health care insurance charges for current employees. Costs for post retirement benefits are for State of Maryland retirees. The State does not distinguish employees by employer/State agency. Instead, the State allocates the postemployment health care costs to all participating employers. The cost of these benefits is expensed when paid. For the years ended June 30, 2013 and June 30, 2012, the State did not allocate postemployment health care costs to participating employers and as a result no contribution was made by the MLGCA.

11. RISK MANAGEMENT

The MLGCA is exposed to various risks associated with the theft, damage, or destruction of assets, torts, and game liability. To manage the related risks, the MLGCA participates in the State's insurance program, which provides general liability, personal and casualty, and workers' compensation insurance. The program requires all agencies to submit premiums based upon proportionate payroll costs and/or claim history. This insurance covers related losses up to a maximum of $1,000,000 per event. Settlements have not exceeded coverage for any of the past three fiscal years. The activity related to accrued workers' compensation costs is included in the schedule exhibited in Note 6.

To minimize risks associated with lottery game liabilities, the MLGCA has established aggregate payout limits for each game type. This approach discontinues sales of the daily numbers games once the potential liability limit is reached for a specific player selection. A maximum payout limit is established for those games with a first-tier prize, which requires multiple first-tier winners to split the related prize.

Risk is minimized for gaming operations as the law requires a VLT to have an average payout of 87% or more but cannot exceed 100%. A casino's gaming floor is to be configured to collectively achieve, at all times, an average payout of 90% but not exceed 95%. For table games, any overall loss for the day is absorbed by the casinos.

SUPPLEMENTAL INFORMATION

Maryland Lottery and Gaming Control Agency
Schedule of Revenues, Expenses and Changes in Net Position - Budget and Actual
For the Year Ended June 30, 2013

	Original Budget	Final Amended Budget	Actual Amounts	Variance with Budget over (under)
Revenues				
Cash Revenue Receipts from all Sources	$ 1,826,853,699	$ 1,888,121,590	$ 2,489,218,420	$ 601,096,830
Expenditures and encumbrances				
Gaming Vendor and Information Technology Fees	17,678,635	18,201,135	18,116,182	(84,953)
Instant Ticket Printing and Delivery	6,430,923	6,430,923	6,435,341	4,418
Salaries, Wages, and Benefits	16,764,428	18,495,173	17,166,867	(1,328,306)
Advertising and Promotions	12,344,990	12,344,990	12,379,162	34,172
Other General and Administrative Expenses	4,982,488	4,982,488	5,029,310	46,822
VLT Special Fund	184,745,750	184,763,505	58,664,559	(126,098,946)
VLT General Fund	69,095,408	69,447,032	69,263,791	(183,241)
Reversions-VLT Special Fund	-	(126,098,946)	-	126,098,946
Reversions VLT General Fund	-	(1,308,330)	-	1,308,330
Reversions-Lottery	-	(202,757)	-	202,757
Total expenditures and encumbrances	312,042,622	187,055,213	187,055,213	-
Excess of Revenues over (under) expenditures	1,514,811,077	1,701,066,378	2,302,163,208	601,096,830
Other Sources (uses) of financial resources				
Transfers in (out)				
State of Maryland Stadium Authority	(19,265,000)	(19,265,000)	(19,265,000)	-
State of Maryland General Fund	(507,464,000)	(507,464,000)	(525,960,121)	(18,496,121)
Other Government Agencies/Funds-VLT	-	-	(376,536,948)	(376,536,948)
Excess of revenues over expenditures and other sources of financial resources	$ 988,082,077	$ 1,174,337,378	$ 1,380,401,139	$ 206,063,761

Reconciliation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

Change in Net Position	$ (7,179,195)
Non-budgetary expenditures:	
Prize Expense	1,038,475,788
Commissions	298,971,711
Depreciation	25,403,648
Bad debt	82,002
Accounting principle differences:	
Accounts Receivable	(3,284,679)
Unearned Revenue	(321,672)
Increase in Fair Value of Investments	640,822
Amortization of Discount Prize Liabilities	3,590,833
Compensated absences	78,821
Worker's Compensation	(11,000)
Capital lease payments and related interest	(25,909,449)
Cash received for VLT/agents	49,863,508
Excess of Revenues over Expenses	$ 1,380,401,139

1. BUDGETING AND BUDGETARY CONTROL

The Maryland Constitution requires the Governor to submit to the General Assembly an annual balanced budget for the following fiscal year. Each year the MLGCA prepares its annual budget and submits it to the Governor. The Governor then presents the State's annual budget (including the MLGCA's) to the General Assembly in accordance with Constitutional requirements. The General Assembly is required to then enact a balanced budget.

The MLGCA's official budget, as adopted by the Legislature, is based upon accounting for certain transactions on the basis of cash receipts and disbursements. Encumbrance accounting, under which purchase orders, contracts, and other commitments for expenditures are recorded as expenditures when the purchase commitment is made, is employed for budgetary purposes. Unliquidated encumbrances are canceled at year-end if it is determined the funds will not be utilized in the future. Unencumbered appropriations lapse at the end of the fiscal year for which they were appropriated. The major differences between the budget basis and the Accounting Principles Generally Accepted in the United States of America (GAAP) basis of accounting are:

- Lottery player prize payments are not budgeted;
- Lottery retailer commissions are not budgeted;
- Beginning October 1, 2012, casino operator commissions were no longer budgeted;
- Revenues are recorded when received in cash (budget) as opposed to when earned (GAAP);
- Expenses (including deferred prizes) are recorded when paid or encumbered (budget) as opposed to when the liability is incurred (GAAP);
- The budget basis excludes depreciation and amortization.

The MLGCA maintains budgetary control by not permitting the total expenditures to exceed appropriations without executive and legislative branch approval.

STOUT,
CAUSEY &
HORNING
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Maryland Lottery and Gaming Control Agency:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Maryland Lottery and Gaming Control Agency (an agency of the State of Maryland) (MLGCA), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Maryland Lottery and Gaming Control Agency's basic financial statements, and have issued our report thereon dated September 30, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Maryland Lottery and Gaming Control Agency's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Maryland Lottery and Gaming Control Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Maryland Lottery and Gaming Control Agency's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charges with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses, or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Maryland Lottery and Gaming Control Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. We noted certain matters that we reported to management of the Maryland Lottery and Gaming Control Agency, in a separate letter dated September 30, 2013.

Purpose of this Report

This purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Stout, Causey & Horning, P.A.

September 30, 2013